IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

No. 410

TRICO PRODUCTS CORPORATION,

Petitioner,

v.

GEORGE T. McGOWAN, Collector of Internal Revenue for the Twenty-eighth District of New York,

Respondent.

PETITIONER'S REPLY BRIEF

BRUCE BROMLEY,
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FRED W. MORRISON,
WILLIAM GILBERT,
RICHARD T. DAVIS,
of Counsel.

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For obvious reasons, respondent has endeavored to present to this Court a different question than those actually presented by the petition and now before the Court for its consideration.

Respondent states (Br., p. 2) that the "question presented" is:

> "Q. Did the lower courts err in finding and holding that in 1936 and 1937, the taxpayer 'was availed of for the purpose of preventing the imposition of the surtax upon its shareholders' and shareholders of the Trico Securities Corporation 'through the medium of permitting (its) earnings and profits to accumulate instead of being divided or distributed' within the meaning of Section 102(a) of the Revenue Act of 1936?"

The petition presents no such question. Well aware that this Court will not undertake a *de novo* determination of questions of fact, petitioner presented for review two clearly defined questions of law. Those questions respondent nowhere meets and for the most part ignores.

I.

As pointed out in the petition (pp. 10-13), the conservation of earnings pursuant to the 1927 recapitalization agreements was necessary not only to bring about the release of more shares (thereby resulting in the payment of more rather than less surtaxes by the controlling stockholders) but also to fulfill the other legitimate purposes of the parties and to provide the corporation with its sole source of capital. The lower courts nevertheless refused to consider those agreements on the stated ground that they "had nothing to do with the needs of the business," thus giving rise to the first question presented by the petition, as follows (Pet., p. 8):

> "1. In determining the applicability of Section 102 of the Revenue Act of 1936, can evidence as to non-surtax saving purposes properly be excluded from consideration on the ground that the carrying out of those purposes satisfied no business need of the corporation?"

Respondent answers petitioner's contention as follows (Br., p. 13):

> "Even if it is here admitted, for the sake of argument, that the release of the restricted shares was one of the dominant purposes back of the accumulations, it remains that the court found that the accumulations were also motivated by tax avoidance purposes. The statute clearly does not require that

> the tax avoidance motive be the sole or even the dominant purpose back of the accumulations."

Respondent's statement misconceives the effect of the lower courts' holding. Respondent implies that all the lower courts did was to find the existence of the condemned purpose together with the existence of an uncondemned purpose. The fact is that the lower courts found the existence of the condemned purpose *only after* they had first excluded any consideration whatever of the 1927 agreements.

In short, the lower courts did not weigh the effect of the 1927 agreements in determining whether a surtax saving purpose existed, but held instead that the 1927 agreements were entitled to no consideration whatever because they "satisfied no business need of the corporation."

Petitioner's point, which has been ignored by respondent, is that the statute cannot be construed to warrant the disregarding of legitimate reasons for conserving earnings, regardless of whether those reasons have any relation to the business needs of the corporation, and that any such construction would in effect convert the statute from a penalty on accumulations for the purpose of avoiding surtaxes to a penalty on accumulations beyond the needs of the business irrespective of actual purpose.

II.

Referring to the limited life of petitioner's windshield wiper patents and to petitioner's program for diversification of products, culminating in the required use of all of the conserved funds for the manufacture and promotion

of the Lift-O-Matic device, the second question presented by the petition was as follows (Pet., p. 9):

> "2. Does Section 102 prevent the conservation of current earnings to meet known and provable future contingencies and exigencies, pursuant to a program of internal corporate financing established long before the tax year involved, simply because the ultimate expenditure of the funds cannot be precisely blueprinted or definitely budgeted in the tax year in question?"

Respondent purports to answer petitioner's contention as follows (Br., pp. 13-14):

> "That contention was also considered and rejected by the District Court (R. 880-892) and by the Court of Appeals (R. 918) principally on the ground that the product (Lift-O-Matic), which had not yet passed its embryonic stage in 1936 and 1937, in fact played no important role in taxpayer's fiscal program in those years."

The foregoing does not answer petitioner's contention; it merely restates the holding of the courts below to which petitioner has taken exception.

Respondent does not and could not dispute the existence of the diversification program during the tax years in question. Neither does respondent question that diversification of products was a matter with which, under the circumstances, the directors could be legitimately concerned. Instead, the view is taken, without explanation or justification, that it was necessary to have the precise product at hand in the particular tax years in question in order to justify the conservation of earnings. The broad question is thereby raised as to whether, under the

statute, a company is entitled to provide in good faith for future needs as well as present needs, within the confines of ordinary good business judgment, even though it is impossible when the funds are conserved precisely to budget those future needs. That question respondent does not even discuss, much less answer.

In *Helvering* v. *National Grocery Company,* 304 U. S. 282 and *Helvering* v. *Chicago Stock Yards Company,* 318 U. S. 693, the Government felt that Section 102 had been too narrowly interpreted by the lower courts in cases involving single stockholders, and in both cases certiorari was granted upon application of the Government "because of the importance in the administration of the revenue laws of the matter presented." The pendulum has now swung the other way with the result, which respondent has not attempted to deny, that there is today widespread fear and uncertainty in the minds of management over the manner of administration of the statute. An authoritative interpretation of the statute by this Court is required.

Conclusion

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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